

Internal Revenue Service

memorandum

CC:TL-N-6867-89

JIROSENBERG

date: **11 JUL 1989**

to: District Counsel, Sacramento District

from: Assistant Chief Counsel, (Tax Litigation)

subject: [REDACTED] Shelters

This memorandum is in response to your May 16, 1989, request for reconsideration of tax litigation advice dated November 17, 1988.

ISSUE

Whether it is appropriate to factor in the available income tax benefits, e.g., the alternative energy or investment tax credit, or accelerated depreciation, when determining the fair market value for [REDACTED] generators utilizing a discounted cash flow analysis.

CONCLUSION

When making a determination of the fair market value of [REDACTED] generators utilizing a disclosed cash flow analysis, it is inappropriate to factor in all of the available tax benefits. There is no authority for including tax benefits when determining fair market value; therefore, tax benefits should not be taken into account until Congress or the Courts mandate otherwise.

DISCUSSION

In an earlier memorandum dated November 17, 1988, (a copy of which was attached to your request) from our office concerning [REDACTED] shelters, we discussed whether it is appropriate to factor in the available income tax benefits when determining the fair market value for [REDACTED] generators utilizing a discounted cash flow analysis. We stated that although there is no authority for separately factoring in tax benefits in this type of analysis, our office's position was that the better approach was not to separately factor in the tax benefits. Our position was based in part upon Tax Court cases where the Court had to determine if certain tax shelter transactions had economic substance to enable the taxpayer to claim available deductions

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and credits from their investment. In these cases, the Court rejected the argument that tax benefits should be taken into account when determining economic profitability under a present value analysis. See Friendship Dairies v. Commissioner, 90 T.C. 44 (1988); and Soriano v. Commissioner, 90 T.C. 44 (1988). We concluded that since there is no authority for separately including tax benefits when determining fair market value, tax benefits should not be taken into account until Congress or the Courts mandate otherwise.

In your memorandum requesting reconsideration of our position, you state that your office believes that tax benefits should be considered in determining fair market value under the discounted cash flow method. However, the only basis of support that you give for your position is, (1) your expert feels strongly that these incentives should be taken into consideration, and (2) in the case of United States v. United Energy Corp. Case No. C-85-3655-RFP(CW), U.S.D.C. N.D. Ca., the government conceded that it would be proper to take into account the tax benefits available to a purchaser in determining the fair market value of an asset for purposes of a section 6700 overvaluation determination. We will address each of your concerns separately.

In response to the first basis of support for your position, while our office is highly impressed with the qualifications of your expert, [REDACTED] and the quality and reputation of his firm, it is our office's opinion that the question of whether tax benefits should be factored in when determining fair market value under a discounted cash flow analysis, is a legal question, to be decided by a legal analysis of all the pertinent case law. Our office has based its position on such an analysis. However, [REDACTED] bases his position on the fact that he foresees various potential problems with revising his report, so it will not include tax benefits in the computation of the cash flow. [REDACTED] stated that he does not know where he should stop once he starts to delete factors that he believes would have been considered by the purchaser. In response to [REDACTED]'s concern, it is our office's position that no tax benefits, whether federal or state, should be taken into consideration for a determination of either fair market value or economic profitability. As a general rule, profit equals economic profit independent of tax benefits. Friendship Dairies v. Commissioner, supra; Herrick v. Commissioner, 85 T.C. 237 (1985); Surloff v. Commissioner, 81 T.C. 210 (1983). State tax credits may not be included in computing economic profit or fair market value for federal income tax purposes because doing so might enable unprofitable activities to be treated as "profitable" activities thereby circumventing Congress' intent that federal credits are available only for genuinely profit oriented activities. Therefore, we recommend that [REDACTED] should revise his report to eliminate all tax benefits, from whatever source they may

derive, for purposes of determining the fair market value of the wind turbine generators.

Your memorandum also states that you believe that taking an approach to the valuation issue which eliminates the anticipated tax benefits would be inconsistent with the government's position in United States v. United Energy Corp., Case No. C-85-365 RFP (CW), U.S.D.C. N.D. Ca. You state that in the U.E.C. case, the government conceded that it would not be improper to take into account the legitimate tax benefits available to a purchaser in determining the fair market value of an asset for purposes of a section 6700. Our office has tried to contact the attorneys for the government in the U.E.C. case, in order to find out what the basis for the government's concession was, and if the Service was involved in the government's decision in making this concession. However, we were informed by the Department of Justice that these attorneys are no longer with the government. In light of this, it is the Service's current position that in determining the fair market value of an asset for purposes of a section 6700 overvaluation determination, tax benefits should not be taken into account. Therefore, taking the position in your expert's report that tax benefits should not be included when determining fair market value under a cash flow analysis, although it may be inconsistent with the government's previous concession in the U.E.C. case, is consistent with the Service's current position for determining fair market value for purposes of a section 6700 overvaluation determination.

In reconsidering our position on this issue, we wish to point out that there are presently several other [REDACTED] projects in the [REDACTED] that have either gone to trial or are in trial preparation where the project attorneys are following the position that our office takes on this issue. See attached copy of May 26, 1989, tax litigation advice to Laguna Niguel District Counsel. We have continuously stressed that a consistent approach should be maintained on all similarly related issues in each of the wind energy projects. The failure to take a consistent approach on this issue in this project may create unwarranted litigating hazards for other tax shelter projects involving a similar issue.


In conclusion, while we recognize that there are hazards connected with the Service's position, the arguments you advance do not merit changing this position. Thus, we still adhere to the position that tax benefits should not be included when making a determination of fair market value under a discounted cash flow analysis. We note that if your office still disagrees with our approach in light of this response, we would be more than willing to schedule a conference call between our office and your office to further discuss this matter.

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Should you have any further questions regarding this matter,
please contact Jeff Rosenberg at (FTS) 566-3233.

MARLENE GROSS

By:


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